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IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

AMERICAN PAPER INSTITUTE, INC.,

Petitioner,

—v.—

AMERICAN ELECTRIC POWER SERVICE CORP., *et al.*,

Respondents.

FEDERAL ENERGY REGULATORY COMMISSION,

Petitioner,

—v.—

AMERICAN ELECTRIC POWER SERVICE CORP., *et al.*,

Respondents.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR PETITIONER AMERICAN PAPER INSTITUTE, INC.

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QUESTIONS PRESENTED

1. Whether the Court of Appeals misapprehended or grossly misapplied the appropriate standard of judicial review in setting aside a rule promulgated by the Federal Energy Regulatory Commission under § 210 of PURPA setting a rate formula for utility purchases of electricity from new qualifying alternative energy sources?

2. Whether, in holding that §§ 210 and 212 of the Federal Power Act provide the exclusive means by which the Federal Energy Regulatory Commission may require utilities to interconnect with qualifying alternative energy sources, the Court of Appeals improperly frustrated the clearly expressed Congressional intent of § 210 of PURPA by rejecting the Commission's contemporaneous construction and harmonization of these statutes?

PARTIES TO THE PROCEEDING BELOW

Parties before the Court of Appeals in addition to petitioner* and respondents named in the caption of this case were intervenors Occidental Geothermal, Inc., Elizabethtown Gas Company and Brooklyn Union Gas Company.

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* A listing of parent companies, subsidiaries and affiliates of petitioner, as required by Rule 28.1 of the Revised Rules of the Supreme Court, appears in the Appendix to this brief, beginning at page A-1.

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BRIEF FOR PETITIONER AMERICAN PAPER INSTITUTE, INC.

OPINIONS BELOW

The opinion of the Court of Appeals for the District of Columbia Circuit is officially reported at 675 F.2d 1226, and is reproduced in Appendix B to the petition of American Paper

Institute, Inc. ("API") for a writ of *certiorari*, at B-1.[1] The order denying rehearing is officially reported at 675 F.2d 1226, 1246, and appears at B-202. The order denying rehearing *en banc*, and the dissenting statement of Circuit Judges Wald and Mikva are officially reported at 675 F.2d 1226, 1247, and begin at B-205.

Federal Energy Regulatory Commission ("FERC" or "the Commission") Order No. 69, dated February 19, 1980, was published in the Federal Register at 45 Fed. Reg. 12,214 (1980), and appears at B-38. FERC Order No. 70, dated March 13, 1980, was published at 45 Fed. Reg. 17,959 (1980), and is reprinted at B-120. The Commission's Order of May 15, 1980, granting in part and denying in part rehearing of Order Nos. 69 and 70, and amending regulations, was published at 45 Fed. Reg. 33,958 (1980), and appears at B-175.

JURISDICTION

On January 22, 1982, the Court of Appeals entered its Judgment. B-200. A timely petition for rehearing and a suggestion for rehearing *en banc* were denied on April 9, 1982. B-202, 205. A petition for a writ of *certiorari* was filed on July 8, 1982, within ninety days of the date of denial of rehearing. The writ was granted on October 12, 1982, and consolidated with *Federal Energy Regulatory Commission* v. *American Electric Power Service Corp., et al.*, No. 82-226. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

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1 Pursuant to Rule 30.1 of the Revised Rules of the Supreme Court, the opinions below and the orders of the Federal Energy Regulatory Commission have been reproduced in Appendix B to API's petition for a writ of *certiorari* in this case and are not being reproduced again. Citations to that Appendix have the prefix 'B' in this brief. Citations to the record of rulemaking, which was before the Court of Appeals, contain the prefix 'R,' and citations to the Joint Appendix have the prefix 'JA.'

STATUTORY AND REGULATORY PROVISIONS INVOLVED

This case involves the following statutory and regulatory provisions set out verbatim in the Appendix to this brief, beginning at the page indicated.

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STATEMENT OF THE CASE

On November 9, 1978, the Public Utility Regulatory Policies Act of 1978, Pub. L. No. 95-617, 92 Stat. 3117 (1978) ("PURPA"), was signed into law. PURPA was part of a comprehensive package of legislation designed to combat the nationwide energy crisis.

A. Information Available to Congress During Consideration of PURPA

As this Court observed in *Federal Energy Regulatory Commission* v. *Mississippi*, ____ U.S. ____, 102 S. Ct. 2126, 2130, (June 1, 1982), when PURPA was being considered by the

Congress, it was said that the generation of electricity consumed more than 25% of all energy resources used in the United States. Approximately one-third of the electricity used in this country was generated through the use of oil and natural gas. These factors had an adverse effect on rates to consumers and on the economy as a whole. Congress accordingly determined that conservation of oil and natural gas by electric utilities was essential to the success of any effort to lessen the country's dependence on foreign oil. In addition to conservation, Congress also determined to promote more efficient use of scarce energy resources.

The evidence before Congress showed that a significant contribution to these ends could be made by alternative sources of energy. For example, "it was estimated that if proper incentives were provided, industrial cogeneration alone could account for 7% to 10% of the Nation's electrical generating capacity by 1987."[2] 102 S. Ct. at 2136.

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2 Cogeneration is the sequential use of energy to produce both electricity and a useful form of thermal energy (such as steam or heat) for industrial, commercial, heating, or cooling purposes. 18 C.F.R. § 292.202(c)(1982). Cogeneration in the paper industry normally consists of production of steam under high pressure which is first expanded through a turbine to generate electric power and then extracted from the turbine at lower pressures and used in the industrial process for such things as mechanical drives, pulping and drying, bleaching and space heating. R 2486-87.

While large public utility generating plants are more efficient in producing electricity than are industrial generating plants which only produce electricity, the sequential reuse of the energy in the cogenerating plant is more efficient overall. A public utility converts 38-39% of the fuel Btu input into electric power. In a typical paper plant, 72% of the total Btu input is used in the manufacturing process and another 10% of the input is converted into electric energy. Thus the paper mill achieves an 82% conversion of available Btu's into useful energy—electric power and process steam—as against only 38% for the utility. Put another way, the typical efficient oil-fired utility plant will produce one kilowatt-hour of electric energy for every 10,500 Btu's of fuel consumed. In a typical cogeneration facility at a pulp mill, the production of one kilowatt-hour consumes approximately 5,400 Btu's of fuel. *See generally* Robert T. Clark, *Theoretical Cogeneration Potential of the U.S. Pulp and Paper Industry* 3, Exhibit 1 (April, 1978). R 949, 956. The potential savings of oil and gas are com-

Section 210 of PURPA reflects Congress' effort to achieve these goals by encouraging the development of cogeneration and small power production facilities.[3]

Earlier this year, this Court upheld the constitutionality of PURPA against a facial challenge. *Federal Energy Regulatory Commission* v. *Mississippi, supra,* 102 S. Ct. 2126. As the Court there observed, Congress believed that two problems discouraged the development of nontraditional sources of electricity. One was the reluctance of traditional electric utilities to purchase the electric power produced by such facilities and to sell them needed backup or supplemental electric power. The other was the threat of state and federal regulation of any such facilities that desired to sell their electrical output. 102 S. Ct. at 2132-33.

B. FERC's Mandate in § 210 of PURPA

Section 210 of PURPA was a remedial statute designed to overcome both of these obstacles to development. In PURPA

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pounded when the paper mill uses its own waste products such as bark or spent chemicals from the pulping process as fuel. Today these waste products constitute approximately 50% of the fuel used at pulp and paper mills. R 2487, Vol. 1, 13SE.

3 A "cogeneration facility" is defined in § 201 of PURPA as one that produces both electric energy and steam or some other form of useful energy, such as heat, used for industrial, commercial, heating, or cooling purposes. 16 U.S.C. § 796(18)(A)(1976 ed., Supp. III). A "small power production facility" is one that produces electric energy solely by the use of biomass, waste or renewable resources (such as wind, water or solar energy) as a primary energy source, and has a power production capacity of not more than 80 megawatts. 16 U.S.C. § 796(17)(A).

By Pub. L. 96-294, 94 Stat. 770, which was signed into law on June 30, 1980, Congress added "geothermal resources" and "geothermal power producers" to various sections of PURPA. That legislation became effective after promulgation by FERC of the rules at issue and is, therefore, not directly relevant to this case. The statutes printed in the Appendix to this brief are, therefore, those in existence at the time the rules under PURPA § 210 were promulgated in February, 1980.

§ 210(a), Congress directed that within one year, FERC was to prescribe:

> "such rules as it determines necessary to encourage cogeneration and small power production which rules require electric utilities to offer to—
>
> (1) sell electric energy to qualifying cogeneration facilities and qualifying small power production facilities and
>
> (2) purchase electric energy from such facilities." 16 U.S.C. § 824a-3(a) (1976 ed., Supp. III).

To overcome developers' and investors' concerns over the threat of state and federal utility-type regulation, PURPA § 210(e) required FERC to:

> "prescribe rules under which qualifying cogeneration facilities and qualifying small power production facilities are exempted in whole or part from the Federal Power Act, from the Public Utility Holding Company Act, from State laws and regulations respecting the rates, or respecting the financial or organizational regulation, of electric utilities, or from any combination of the foregoing, if the Commission determines such exemption is necessary to encourage cogeneration and small power production." 16 U.S.C. § 824a-3(e).

The statute further directed FERC to promulgate its rules after consultation with state and federal regulatory agencies, and after public notice and a reasonable opportunity for interested persons to submit oral and written data, views and arguments. 16 U.S.C. §§ 824a-3(a),(e).

C. FERC's Rulemaking Proceedings

Pursuant to that Congressional direction, FERC instituted two major rulemaking proceedings. In one proceeding, FERC Docket No. RM79-54, the Commission considered and determined how and which cogeneration and small power produc-

tion facilities may become "qualifying" facilities. In the second proceeding, FERC Docket No. RM79-55, the Commission considered and promulgated rules which frame the relationship between qualifying facilities and electric utilities under PURPA § 210, and defined the scope of the exemptions from regulation that would be necessary to encourage development of such facilities.[4] A brief recitation of the principal activities involved in these proceedings will illustrate the thoroughness and dedication with which the Commission pursued its appointed task.

In June of 1979, FERC issued proposed rules in Docket No. RM79-54. R 348-388H. FERC also issued at that time a Staff Discussion Paper in Docket No. RM79-55, which addressed numerous issues relating to the relationship of qualifying facilities and utilities, and to the appropriate scope of exemption from utility-type regulation. JA 6. Public hearings were held in San Francisco, Chicago and Washington, D.C. with respect both to the proposed rules and to the Staff Discussion Paper. R Vol. 1, 1-119SF, 1-87Chi, 1-280DC1. Extensive written comments were also received.

On October 18, 1979, the Commission issued a Notice of Proposed Rulemaking under § 210 of PURPA in Docket No. RM79-55, made available its preliminary environmental assessment of the proposed rules and invited further public comment. JA 36. In order to obtain the data, views and arguments of interested parties, FERC again held public hearings in four cities across the Nation in November and December, 1979. R

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4 American Paper Institute, Inc., is the national trade association of the pulp, paper and paperboard industry in the United States. R 932. This industry is the Nation's leader in the self-generation and cogeneration of electric power, and accounts for over 40% of all cogeneration in the United States today. As an industry it is also the Nation's third largest *purchaser* of electricity from electric utilities. API actively participated in the rulemaking proceedings, submitting comments on four separate occasions. R 932, 1393, 2014, 2486. In addition, API representatives testified at hearings conducted by FERC. R Vol. 1, 12 SE (Hearings in Seattle, Washington, November 19, 1979).

Vol. 1, 1-169SE, 1-296NY, 1-180Col, 1-347DC2. Again, voluminous written comments were received.

After consideration of this information, the Commission made available final draft rules in January, 1980. R 3403-05. State public utility commissioners and electric utility representatives commented on this draft at separate public meetings held February 5 and 8, 1980. R Vol. 1, 1-165DC3, 1-186DC4. All comments were considered before the Commission issued Order No. 69, its final rules in Docket No. RM79-55 implementing § 210 of PURPA, on February 19, 1980. B-38. The Commission then issued Order No. 70, its final rules with respect to qualification of facilities in Docket No. RM79-54 on March 13, 1980. B-120.

On March 19 and 20, and April 3, 1980, the Commission received the petitions and applications for rehearing of the respondents in this case, American Electric Power Service Corp., Consolidated Edison Co. of New York, Inc., and Colorado-Ute Electric Association, Inc. R 3458, 3568, 3595. These petitions challenged the rules at issue here with essentially the same arguments as the utilities later presented to the Court of Appeals. In addition, at least one petition urged FERC to adopt a percentage-of-avoided costs rate for purchases. R 3553. On May 15, 1980, having duly considered these and other requests for rehearing of Order Nos. 69 and 70, FERC granted them in part and denied them in part and amended four sections of its rules involving small power production. B-175.

The procedures and deliberations described above were among the most comprehensive the Commission has ever undertaken. The final rules, produced after developing a record of over 4,000 pages of written comments and recorded testimony, address virtually every significant aspect of the relationship between qualifying facilities and utilities. B-105-19; B-167-74.

In July, 1980, three electric utilities, respondents in this Court, sought review of four rules in the Court of Appeals for

the District of Columbia Circuit. Two of those rules were upheld by the Court of Appeals and are not the subject of this brief. The other two rules, which go to the very heart of § 210 of PURPA, were set aside. The first of those was the so-called "avoided costs" portion of the purchase rate rule. 18 C.F.R. § 292.304(b)(2)-(4). This rule established the criteria for determining the rate which utilities would be required to pay for purchases of electricity from qualifying facilities constructed after the effective date of PURPA, absent agreement between the parties. The other rule vacated by the Court of Appeals simply required electric utilities to interconnect with qualifying facilities in order to enable purchase and sale transactions to take place. 18 C.F.R. § 292.303(c)(1).[5]

SUMMARY OF ARGUMENT

In rejecting FERC's purchase rate rule, the Court of Appeals' panel applied the wrong standard of review. The correct standard of review is the "arbitrary and capricious" test. Even under the heightened standard of review (the "substantial evidence" test) which the panel apparently applied, it grossly misapprehended or misapplied the test by arrogating to itself the interest-balancing functions entrusted by Congress to the Commission, and by requiring FERC to develop a rule in accordance with the court's own preferences. In so doing, it disregarded numerous decisions of this Court that a reviewing court should not substitute its judgment for that of the agency charged by Congress with the proper administration of the statute.

It also refused to follow this Court's admonishment to give due regard to the administrative expertise of the agency. The panel below failed to recognize that FERC's purchase rate rule

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5 The proceedings in the court below are described in detail in the brief for the Commission in No. 82-226, and will not be repeated here. The full text of the Commission's rules is found at B-105-19.

did not establish a fixed dollar amount to be paid by utilities. .. assumed incorrectly that the rule would always result in utilities paying the full avoided costs for energy produced by new qualifying facilities.

FERC drafted its rules to encourage utilities and developers of potential alternative energy sources to negotiate their relationship. At the same time, FERC, recognizing the leverage that utilities have in such negotiations, accommodated the Congressional policy to encourage alternative energy sources by improving the bargaining posture of those wishing to construct new qualifying facilities. The panel, however, insisted that such encouragement must be tempered by making available to utilities' customers whatever short-term benefits could be extracted regardless of how insignificant they may be, and refused to consider the long-term benefits to the customers and public at large. These long-term benefits include reducing the Nation's dependence on foreign sources of oil and the more efficient use of energy resources, as well as ancillary benefits to consumers including reduced utility capital requirements, improved reliability of supply through more decentralized generation and environmental benefits. All of these factors were developed on the record and considered by FERC in selecting the rate formula.

With respect to the interconnection rule, the Court of Appeals, contrary to well-established rules of law, rejected the Commission's rational harmonizing of its own enabling statutes. The panel applied an unreasonably restrictive view of Congressional intent in enacting PURPA, and thereby denied FERC the power Congress obviously sought to give. By requiring FERC to conduct case-by-case hearings under the Federal Power Act as a predicate to interconnection for purchase or sale transactions, the panel overrode PURPA's express determination that the implementation function be performed by the state regulatory authorities. Its view imputes to Congress the contradictory intention of encouraging cogeneration and small power production in one paragraph of the statute, while stifling development of those sources in a different

paragraph of the same statute. In so construing the statute, it failed to heed this Court's direction that statutes are to be construed as a whole in order to harmonize all parts and give effect to each. Instead, it assumed a degree of prescience in the draftsmen which this Court has stated cannot be given.

The decision below ignores FERC's Congressional mandate to prescribe such rules as it determines necessary to encourage cogeneration and small power production and creates a formidable, and perhaps insurmountable, roadblock to a major energy program.

ARGUMENT

I.

IN SETTING ASIDE THE COMMISSION'S PURCHASE RATE RULE, THE COURT BELOW APPLIED THE WRONG STANDARD OF REVIEW, IMPROPERLY SUBSTITUTED ITS JUDGMENT FOR THAT OF THE COMMISSION, AND MISUNDERSTOOD THE PURPOSE AND EFFECT OF THE RULE

A. The Court Below Should Have Applied the "Arbitrary and Capricious" Standard of Review and Upheld the Commission's Rule

This Court has repeatedly stated that regulations promulgated after informal rulemaking are subject to an "arbitrary and capricious" standard rather than the "substantial evidence" test that the panel presumably applied.[6] *See, e.g., FCC*

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6 As stated by the dissenters from the Court of Appeals' denial of rehearing below, "[t]he panel's opinion appears to assume that the substantial evidence test governs review of rules promulgated under the Public Utility and [sic] Regulatory Policies Act of 1978, Pub. L. No. 95-617, 92 Stat. 3117 ('PURPA'). *See* slip op. at 13 (*citing* Public Sys. v. FERC, 606 F.2d 973 (D.C. Cir. 1979))," B-207, n.2.

The court's application of the substantial evidence test may have been the result of an erroneous assumption—that the Court of Appeals had jurisdiction to review PURPA § 210 rules directly under § 313(b)

v. *WNCN Listeners Guild,* 450 U.S. 582, 594 (1981); *FCC* v. *National Citizens Committee for Broadcasting,* 436 U.S. 775, 802-03 (1978). Judges Wald and Mikva, dissenting from the denial of rehearing below, stated correctly that:

> "PURPA . . . does not set forth a heightened standard of review. The avoided cost rule is therefore subject to the general requirements of the APA, and may be overturned if it is 'arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.' 5 U.S.C. § 706 (2)(A)." B-207, n.2.

Under that standard, "[t]he court is not empowered to substitute its judgment for that of the agency." *Citizens to Preserve Overton Park* v. *Volpe,* 401 U.S. 402, 416 (1971).

When Congress directs an administrative agency to promulgate rules, the reviewing court has a limited function. As this Court stated in *United States* v. *Shimer,* 367 U.S. 374, 383 (1961), if the choice made by the agency:

> "represents a reasonable accommodation of conflicting policies that were committed to the agency's care by the statute, we should not disturb it unless it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned."

Here, of course, Congress sanctioned a purchase rate which would encourage cogeneration and small power production. Its

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of the Federal Power Act ("FPA"), which prescribes the substantial evidence test for review of Commission actions under the FPA. 16 U.S.C. § 825*l*(b). API raised this jurisdictional issue on petition for rehearing below. The panel apparently believed it had pendent jurisdiction because one of the issues below (the so-called "fuel-use" issue) arose in the court's review of rules issued under § 201 of PURPA, which, unlike § 210, is an amendment to the FPA. 16 U.S.C. § 796. Even with pendent jurisdiction properly asserted over review of the PURPA § 210 rules, however, the appropriate standard of review is *not* a matter over which the court may similarly exercise its discretion. The Administrative Procedure Act, not the FPA standard, applied to the court's review of the rules at issue here.

primary limitation was that the rate not exceed the avoided costs of the purchasing utility; and it is not contended that the purchase rate rule promulgated by the Commission does so.[7]

The agency is only required to set out the reasons for its rulemaking in a "concise general statement of [the rules'] basis and purpose." Administrative Procedure Act § 4(c), 5 U.S.C. § 553(c)(1976). The Administrative Procedure Act does not require detailed and comprehensive findings of fact. *Camp* v. *Pitts*, 411 U.S. 138, 143 (1973). A "curt" explanation which indicates "the determinative reason for the final action taken" satisfies the statutory requirement. *Id.* at 143.[8] As described *infra* at 16-17, the Commission's explanation of its determination to adopt the avoided costs standard far exceeded these minima.

This Court has recognized that agency decisions "must sometimes rest on judgment and prediction rather than pure factual determinations." *FCC* v. *WNCN Listeners Guild*, *supra*, 450 U.S. at 594. "In such cases," the Court observed, "complete factual support for the Commission's ultimate conclusions is not required since ' "a forecast of the direction in which future public interest lies necessarily involves deductions based on the expert knowledge of the agency." ' " *Id.* at 594-95 (citations omitted).

The decision below failed to give due consideration to the obvious fact that at the time of the rulemaking extensive experience with alternative energy sources was lacking, and it was difficult to predict with any degree of assurance the

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7 The Court of Appeals acknowledged that FERC's avoided costs standard "is identical to the statutory concept of the 'incremental cost . . . of alternative energy.' " B-8, n.28.

8 *See also Bowman Transportation Inc.* v. *Arkansas-Best Freight System, Inc.*, 419 U.S. 281, 290 (1974) ("we can discern in the Commission's opinion a rational basis for its treatment of the evidence, and the 'arbitrary and capricious' test does not require more").

specific consequences of any particular rate for purchases.[9] FERC was required, nonetheless, to apply its expertise in developing rules which would accomplish the Congressional directive to encourage cogeneration and small power production. Accordingly, FERC adopted a purchase rate rule which, in the Commission's judgment, "may provide a significant incentive for a higher growth rate of these technologies." B-65.

FERC weighed the competing interests and determined that although a rate based on avoided costs would not produce any significant rate savings to the utilities' customers, in the long run they and the Nation as a whole would benefit from the resulting decreased reliance on scarce fossil fuels and more efficient use of energy. *See* B-65.[10] That determination was not arbitrary or capricious, and the panel below was not authorized to reject it.

B. Even Under a Substantial Evidence Test the Court of Appeals Misapplied that Standard by Supplanting the Commission's Balance of the Pertinent Interests with Its Own

The failure of the panel below to uphold FERC's avoided costs rule may be traced to several causes, not the least of which is that it simply disagreed with the determination made by the Commission that the avoided costs standard was just and reasonable to ratepayers and at the same time was the most viable means of attaining Congress' goal of encouraging development of alternative energy sources.

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9 Many commenters recognized that the rules should be periodically reviewed, and revised if necessary. R 1249, 2477, 2786. Congress recognized that this was desirable, especially given the abbreviated time frame it had allowed for the Commission's work. It specifically directed in § 210(a) that "the Commission shall prescribe, and from time to time thereafter revise, such rules . . . ." 16 U.S.C. § 824a-3(a). FERC and the participants in the rulemaking proceedings recognized these conditions. The Court of Appeals panel failed to do so.

10 With respect to the various interests and benefits considered by FERC, see pp. 18-25. *infra*.

Although, as noted earlier, the Commission's rule was within the permissible range established by Congress, the court set the rule aside because it was at the upper bound of that range. The panel's preconceived notion of an appropriate rate was presaged when it rejected FERC's initial challenge to the utilities' standing:

> "If petitioners prevail before this court, the rule will be changed to permit the states to allow the petitioners to purchase electricity at prices lower than those now required." B-7, n.26.

A fair reading of the opinion indicates that the panel simply imposed its perspective of the public interest on FERC. The panel makes it clear that in its view the only purchase rate which it would call just and reasonable to consumers would be one requiring utilities to pay something less than avoided costs. Thus, the panel directed that:

> "FERC should allocate the benefits more evenly between the cogenerators and the utilities if the utilities can demonstrate that, under a percentage of avoided cost approach, an allocation less heavily favoring the cogenerators is in the public interest and the interest of the utilities' electric consumers, and will not disproportionately discourage cogeneration." B-12.

In so stating, the panel manifested its determination that only a rule which in the short term saved utility customers a few cents per month on their electric bills could satisfy the statutory mandate that FERC's purchase rate be "just and reasonable" to those customers, and that such short-term consumer gain outweighs their own as well as the Nation's long-term interest in developing alternative energy sources. However, the determination of what weight should be accorded the short- versus the long-term interests of consumers and other interests required to be considered were, according to PURPA § 210, to be made by FERC, not by the Court of Appeals.

Having decided that the rate contained in the rules was too high, the panel made it clear that on remand the Commission should promulgate the purchase rate rule which the panel itself preferred. Thus, it stated that on remand:

> "[W]e expect the Commission to take a harder look at, especially, the percentage of avoided cost approach. Such an approach might, for example, entail FERC setting a specific percentage, or FERC might permit state commissions to set rates within a range—*e.g.*, 80-100 percent—authorized by the Commission." B-12.

But FERC had considered and rejected a percentage of avoided costs approach, and had fully explained its reasons for so doing. It gave several reasons for adopting the avoided costs standard:

> "[I]f part of the savings from cogeneration and small power production were allocated among the utilities' ratepayers, any rate reductions will be insignificant for any individual customer. On the other hand, if these savings are allocated to the relatively small class of qualifying cogenerators and small power producers, they may provide a significant incentive for a higher growth rate of these technologies." B-65.

Moreover, FERC said:

> "Although use of the full avoided cost standard will not produce any rate savings to the utility's customers, several commenters stated that these ratepayers and the nation as a whole will benefit from the decreased reliance on scarce fossil fuels, such as oil and gas, and the more efficient use of energy." *Id.*

Finally, FERC took particular note of comments that:

> "[U]nder the full avoided cost standard, the utilities' customers are kept whole, and pay the same rates as they

would have paid had the utility not purchased energy and capacity from the qualifying facility." *Id.*

The Court of Appeals refused to give credence to FERC's rationale for the rule. The panel stated that "it is possible that if cogeneration becomes substantial, a rate uniformly set at the statutory ceiling may be quite costly to electric consumers." B-11. The panel never explained the basis for this conclusion. It reflects, however, a fatal misunderstanding about the nature of avoided costs which infects the panel's entire opinion on this subject. By definition, the utility can incur no greater cost in purchasing power from a qualifying facility than it would experience if the utility generated the power itself or obtained it elsewhere. *See* 18 C.F.R. § 292.101(b)(6). As a result, the consumer will not pay more on account of sales by a qualifying facility.

Furthermore, the panel grossly misapplied the Congressional policy to encourage cogeneration by directing FERC to issue a rule which "will not *disproportionately discourage* cogeneration." B-12 (emphasis added). That was not the Congressional mandate. Rather, Congress expressly ordered FERC to do what it could to *encourage* cogeneration. *See Federal Energy Regulatory Commission* v. *Mississippi, supra*, 102 S. Ct. at 2132-33. FERC recognized that utility ratepayers were not to be required to subsidize cogenerators or small power producers. *See* JA 48; B-49; R 352. It also recognized, however, as did Congress, that encouragement would come only from economic viability. FERC chose a purchase rate for new facilities, therefore, which was within the limits prescribed by Congress, albeit at the upper end of the permissible range, in the exercise of its informed judgment that such a rate was necessary to encourage those projects. B-67-68.

In its insistence upon a "split the baby" approach to rate-making policy as between utilities and qualifying facilities, the

Court of Appeals disregarded the record, ignored FERC's reasoned consideration of the record and suggested that the utilities be given yet another opportunity to convince FERC to adopt a lower rate.

As this Court has recognized, however, judicial activism of this sort is improper. *See Vermont Yankee Nuclear Power Corp.* v. *NRDC*, 435 U.S. 519 (1978). Under the "substantial evidence" test, "[t]he court's responsibility is not to supplant the Commission's balance of these interests with one more nearly to its liking, but instead to assure itself that the Commission has given reasoned consideration to each of the pertinent factors." *Permian Basin Area Rate Cases*, 390 U.S. 747, 792 (1968); *see also Mobil Oil Corp.* v. *FPC*, 417 U.S. 283, 308 (1974).

C. In Arriving at its Avoided Costs Rule FERC Considered Each of the Interests Required by the Statute

(1) The Public Interest

The Court of Appeals simply ignored or refused to consider FERC's analysis, based upon the record, of the benefits available to the Nation from PURPA-induced cogeneration.

In its comments in Docket No. RM79-54, API submitted a study which estimated that in 1977, the fuel efficiency of industrial cogeneration resulted in a savings equivalent to 49 million barrels of oil, compared to the fuel that would have been consumed by utilities to produce the same amount of electricity. *See* Robert T. Clark, *Theoretical Cogeneration Potential of the U.S. Pulp and Paper Industry* 1 (April, 1978). R 947.

FERC itself projected during the course of this rulemaking that the successful implementation of PURPA would induce the additional development of 3,410 megawatts ("MW") of new industrial cogeneration capacity by 1995. R 2277, 2292. This capacity translates into additional fuel savings equivalent

to more than 21 million barrels of oil annually.[11] Since the commercial sector is expected to add another 2,500 MW of cogeneration capacity due to PURPA, R 2291, the total PURPA-induced savings available from cogeneration and small power production was estimated to approach the equivalent of 37 million barrels of oil annually.

The immediate economic effects of these savings are readily identifiable. Consumers will tend to experience lower prices for fuel than would otherwise exist with higher levels of demand.[12] In addition, the more efficient use of fuel through PURPA-induced cogeneration will result in net cost reductions for manufactured goods.

Such substantial savings are bound to have a positive impact upon the Nation's ability to control its own future with respect to energy resources. To the extent the savings will permit reducing imports of foreign oil and gas, American consumers will obtain relief from the artificially high prices of these fuels, as well as from the political and social costs that accompany overdependence on them.

The record further shows that PURPA-induced cogeneration and small power production will result in deferral or cancellation of construction of massive utility generating facilities, and will correspondingly diminish the potential environmental damage that accompanies such construction. Facilities, originally slated for construction between 1980 and 1995 which will be deferred as a result of this program have been projected by the Commission to include:

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11 This fuel savings assumes that 3,410 MW of industrial cogeneration capacity produces 25.391×10^9 kWh of electricity annually (at 85% utilization) at a fuel savings of 20-30% over utilities' central generation capacity. *See* R 2274.

12 The Commission estimated that approximately two-fifths of the fuel savings produced by PURPA will impact on the consumption of oil and natural gas; the remaining savings will affect the consumption of coal. *See* R 2258.

> "some eleven 500 MW coal-fired steam plants, one-1000 MW nuclear plant, a number of 75 MW gas turbines, and certain large scale hydropower and combined cycle installations." R 2258.

As stated in the Commission's assessment:

> "All of the environmental impacts associated with the construction and operation of these facilities would be avoided." *Id.*

(2) The Interests of Cogenerators and Small Power Producers

As the legislative history of PURPA § 210 made abundantly clear, one of the greatest obstacles to developing a cost effective alternative energy source was the reluctance of utilities to pay adequate rates for power purchased from those sources. *See Federal Energy Regulatory Commission* v. *Mississippi, supra,* 102 S. Ct. at 2132, n.12. Even where utilities were willing to purchase power, investors in such facilities could not rely on sufficient income to meet their costs, and to justify the risk and major capital expense required. The result is that a vast untapped resource lies dormant.[13] The paper industry, for example, is currently operating at only about one-third of its potential generating capacity. R 957-58.

FERC recognized that there is no particular price at which power generation becomes economic for all operators. Local energy costs, plant design and internal requirements are but a few of the many variables which make the investment decision unique to each potential developer.[14] Yet as FERC also recog-

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13 FERC's selection of a purchase rate at the avoided costs limit applies only to newly constructed facilities, *i.e.*, those whose construction commenced on or after November 9, 1978, the date when PURPA became law. 18 C.F.R. § 292.304(b). This rulemaking decision was obviously directed at this untapped resource.

14 Qualifying facilities are diverse and varied. They range from windmills, photovoltaic arrays and hydroelectric dams to industrial co-

nized, if the facility can produce electricity at a cost to the utility *no greater* than the utility would otherwise incur in purchasing or producing that electricity, the public, the utility and the utility's ratepayers will benefit. *See* B-65.

Throughout the rulemaking proceedings, one point was abundantly clear. If a prospective developer of an alternative energy source is to be encouraged to undertake the risk of developing a project, he must have a price sufficient to cover his costs (including costs of financing), and to compensate him for the risks he is undertaking. R 1291, 2423, Vol. 1, 213DC1, 57-58DC4. FERC recognized this. B-49. The generation of electricity is not the primary business of private industrial developers, and it will not be pursued unless potential returns are high enough to compete successfully in the company's capital budgeting process. Moreover, it was pointed out by commenters that many such projects require outside financing, but potential investors and lenders will not commit the neces-

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generation facilities. They range in size from less than 10 kilowatts, R 776, to larger than 200,000 kilowatts. *Public Utilities Regulatory Policies Act Amendments: Hearings on S. 1885 and S. 1966 Before the Subcomm. on Energy Regulation of the Senate Comm. on Energy and Natural Resources*, Part 1, 97th Cong., 2d Sess. 268 (1982) (supplemental statement of C.M. Butler III, Chairman, Federal Energy Regulatory Commission). They vary in cost from less than $10,000, R 3270, to more than $100,000,000. Wall Street Journal, February 25, 1982, p. 12, col. 4. They are owned by large industrial corporations and by individuals of very modest means. Their capital and energy costs may range from 3 cents per kilowatt-hour to more than 12 cents. *See* R 432.

Utilities also exhibit great diversity. Some are capacity short, others have excess capacity. *E.g., compare* R Vol. 1, 63NY *with* Wall Street Journal, November 17, 1982, p. 24, col. 1. Some generate almost exclusively with high cost fuels such as oil or gas, others generate at low cost with coal or water power. *See* U.S. Dept. of Energy, Inventory of Power Plants in the United States: 1980 Annual (DOE/EIA-0095 (80)). Avoided costs may range from less than 2 cents per kilowatt-hour to more than 8 cents. *Compare*, Iowa State Commerce Commission Order TF-81-202, Docket No. RMU-80-15-152 (1982) *with* New Hampshire Public Utilities Commission Order No. 14,280, Docket DE 79-208 (1980).

sary funds unless the project appears to be economically sound.[15] R 1311, 2882, Vol. 1, 86SF. A principal test of that economic viability is whether the anticipated receipts from the sale of power generated are sufficient to defray expected capital costs and expenses and yet permit a reasonable return for investors. R 883-84, 1291, 3374. Moreover, the more innovative the technology used in the project, the greater the risks to the developer. R Vol. 1, 134Col. If those innovative projects are to be undertaken, of course, some reward must be provided for the risk takers. R 1309-11, Vol. 1, 181-82DC1, 185DC1. FERC's rules took these facts into consideration; the Court of Appeals panel ignored or denigrated them.

(3) The Interests of the Consumers of Electricity

The additional power which will be supplied to utilities as the result of § 210 of PURPA will benefit consumers of electricity because it will improve the financial and operational viability of utilities. Utilities may expect four major benefits from PURPA-induced cogeneration and small power production, all of which they will receive cost-free, since they will incur expenses no greater than would have been experienced in the absence of PURPA-induced cogeneration and small power production. R 907.

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15 For example, Potsdam Paper Corp. pointed out that payment of avoided costs "would materially improve the ability of our company to obtain financing for our project in that the viability would not be solely dependent on the ability of the paper mill to take the electric output of the project. The intended incentive would place in front of the perspective [sic] lender a sales arrangement to a utility which would demonstrate ability to repay apart from our paper making operations." R 2882.

A broad spectrum of other potential developers expressed similar sentiments. *See, e.g.*, Comments of the Hawaiian Sugar Planters Association, R 1334, "the avoided costs' pricing standard . . . will constitute a necessary incentive for the production of additional biomass power by Hawaiian sugar factories;" testimony of the American Wind Energy Association, R Vol. 1, 134Col, "payment of full avoided costs could be necessary to bring any significant amount of generation stock on line soon."

i. Utilities will broaden and diversify their sources of electric power. This will insulate them to some extent from increases in the price of scarce fossil fuels, as well as from unexpected fluctuations in the availability of these fuels. *See* R 1522, 2459, Vol. 1, 153NY. Utilities' customers will receive the benefit of increased reliability of service resulting from their utility's diversified generation mix. R Vol. 1, 153NY.

ii. Utilities will obtain increased electrical generating capacity without expenditures for new plant and equipment. *See* R 3367, Vol. 1, 16 DC2, 142DC1.

iii. Since utilities will require no new financing to obtain this additional capacity, they will avoid any negative repercussions that might otherwise be experienced in going to the money market. In particular, they will avoid the business risk attendant to long-term financing at the high interest rates which exist today and are likely to persist. *See* R 1523-24, 3372, Vol. 1, 32-33NY.

iv. Utilities will be able to match more closely the growth of their capacity with growth in demand, and, consequently, to realize associated cost savings. This is because qualifying facilities will usually provide capacity in smaller increments than it would be cost-effective for utilities to build, and because new capacity from such facilities may be brought on line in shorter lead times than typically accompany the construction of large-scale central generating stations. *See* R Vol. 1, 151-52NY.

The record clearly demonstrated that the avoided costs rate is just and reasonable to the electric consumer.[16] The FERC rules preclude any increase in rates as a result of power purchases from qualifying facilities. R 907. In fact, the rules often may result in decreased rates to consumers.

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16 The National Association of Regulatory Utility Commissioners gave its full support to FERC's avoided costs rule. R 2833. Not a single one of the state utility regulatory commissions—which must be recognized

Under the Commission's rules, a utility is only required to pay for power when it is delivered and, therefore, ratepayers are not paying capital costs for new facilities before they come on line. Indeed, they will never have to pay for something they may never get.[17] Commenters during the rulemaking pointed out, on the other hand, that absent alternative energy sources, utilities would be obligated to obtain equivalent power by, in many cases, constructing new generating facilities. R 907, Vol. 1, 151-52NY. The costs of those new facilities are incurred long before they produce a single kilowatt of power and are often paid for by the utilities' current ratepayers even though benefits may not be received from the facilities for many years, if ever.

The Commission's rules similarly treat the ratepayer fairly in situations where the utility's existing facilities are more than adequate to meet its total system load. Thus, the rules require purchases of all electric energy and capacity available from a qualifying facility, but provide that the "purchase rate should only include payment for energy or capacity which the utility can use to meet its total system load." 18 C.F.R. § 292.303; B-53.[18]

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as the guardians of the ratepayers' interests—has sought a waiver of the rule. The paper industry represented by API purchases vastly more electricity than it sells, and therefore—unlike the utilities—has a vital interest as a ratepayer.

17 This is in stark contrast to the consumer's plight in many areas of the Nation today. The Washington Public Power Supply System, for example, currently owes $2.25 billion in principal and $4.75 billion in interest for two incomplete nuclear-power plants which were abandoned because of cost overruns. New York Times, January 23, 1982, p. 31, col. 3. These cancellations may result in rate increases for consumers of up to 80%. Wall Street Journal, January 28, 1982, p. 16, col. 2.

18 For example, the purchase rate should only include payment for capacity when the availability of capacity from the qualifying facility will enable the utility to reduce its capacity requirements by deferring the construction of new plants or deferring commitments to firm power purchase contracts. 18 C.F.R. § 292.304(e); B-77.

Finally, the Commission's rules provide a "safety valve" procedure by which a state regulatory authority may apply to FERC for a lower rate whenever it believes an avoided costs rate is not necessary to encourage cogeneration and small power production.[19] 18 C.F.R. § 292.403. If, as the panel believed, a purchase rate based on avoided costs might in some cases excessively favor alternative energy sources, a waiver sought by the state agency charged with protecting the interests of all utility customers is the appropriate remedial course. Judicial nullification of the rule was not.

D. The Court of Appeals Misapprehended the Purpose and Effect of the Avoided Costs Rule

The Court of Appeals apparently believed that all purchases of electricity from qualifying facilities would be at the utilities' avoided costs. It considered the avoided costs part of the purchase rate rule in isolation and failed to put it into the context of the entire PURPA § 210 rules. Those rules endorse arrangements between utilities and qualifying facilities in which the parties negotiate a rate for purchases, or terms and conditions relating to purchases, which differ from the rate or terms otherwise required by the rules. 18 C.F.R. § 292.301(b)(1).

There are a number of reasons why a potential developer will attempt to engage in negotiations with a utility rather than going before a state public service commission for an avoided costs rate. State commission proceedings are time consuming

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19 This Court has repeatedly indicated that an agency's discretion to proceed in complex areas through general rules is closely connected to the existence of a "safety valve" procedure that allows the agency to consider applications for waivers based on special circumstances. *See E.I. duPont DeNemours & Co.* v. *Train*, 430 U.S. 112, 128 (1977); *Permian Basin Area Rate Cases, supra*, 390 U.S. at 771-73; *National Broadcasting Co.* v. *United States*, 319 U.S. 190, 207, 225 (1943). As noted earlier, not a single state public utility regulatory commission to date has considered it necessary to apply for a waiver of the avoided costs portion of the purchase rate rule.

and expensive. A utility may also seek judicial review of a state commission order and thereby cause further delay and expense. A decision by a developer to construct a project and a decision by a bank to finance a project require a degree of certainty regarding the economic viability of the project. A negotiated contract can provide certainty. It can insulate the developer from future changes in a state public utility commission's rules or rates and declines in avoided costs during the project construction period.[20]

Once the developer decides to bargain, he is faced with the substantial leverage of the utility. A qualifying facility generally has only one available utility to which its electric energy can be sold. Numerous commenters in the Commission's rulemaking referred to the monopsony power of the utilities and the effect of such market power on the negotiating position of prospective developers.[21] R 1186-87, 1523, Vol. 1, 186DC1, 219DC1. The owners of qualifying facilities testified that this monopsony power could force developers to enter into arragements with that utility on terms dictated by the utility. R 2443, 2843-44, Vol. 1, 38 Col.

The utility, which already possesses an intimate knowledge of its own costs, is in an inherently advantageous position in negotiating with the developer regarding the proper treatment of the factors to be considered in the calculation of avoided

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20 Any number of factors could result in lower avoided costs at a particular time, *e.g.*, a temporary drop in the price of oil, the bringing on line by the utility of a new plant which may have been under construction for several years, or the construction of several other qualifying facilities in the utility's service area.

21 The panel's criticism of FERC for failure to find that utilities possess monopsony power, B-16, suggests a limitation on FERC which is nowhere stated or implied in PURPA § 210. As this Court is aware, the Commission has had substantial experience in dealing with utility use and abuse of monopoly and monopsony power. *See Otter Tail Power Co.* v. *United States*, 410 U.S. 366 (1973); *see also* Meeks, J., *Concentration in the Electric Power Industry: The Impact of Antitrust Policy*, 72 Col. L. Rev. 64 (1972).

costs.[22] *See* R 1403, 3373. Moreover, utilities have little, if any, incentive to estimate their avoided costs accurately.[23] If, as is often the case, qualifying facilities are considered to be unwanted competition, there is considerable incentive for a utility to *under*state its costs.[24] The expense of disproving a utility's avoided costs figure is prohibitive for all but the very largest qualifying facilities. *See id.*

Another leverage point is delay. Utilities which stall negotiations can effectively kill many projects. Costs escalate and investment capital may be appropriated to other uses. In addition, much of the new cogeneration in the United States will be ancillary to expansions in plant capacity or to the reconstruction or replacement of obsolescent or inefficient boilers and related equipment. Delays may cause the owner of the reconstruction or replacement to forego the option to

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22 The flexibility of FERC's avoided cost formula itself encourages negotiation. It is not a mathematical formula. The factors required to be considered by the state regulatory authorities are neither quantified numerically nor weighted relative to each other. Such factors include the ability and willingness of the developer to enter into a firm commitment to deliver the power, which commitment may include significant penalty provisions for failure to deliver; another element of the calculation is the developer's ability to separate the facility's load from its generation during emergencies. 18 C.F.R. §§ 292.304(e)(2)(iii) and (v). Other such factors include the willingness or ability of the developer to permit the utility to dispatch—control the output of—the facility, 18 C.F.R. § 292.304(e)(2)(i), and the time of day or the season that the facility's energy is to be made available, 18 C.F.R. § 292.304(e)(2).

23 The rules require each regulated utility to submit data from which avoided costs may be derived to its state regulatory authority no later than November 1, 1980, May 31, 1982, and not less often than every two years thereafter with certain exceptions not here relevant. Non-regulated utilities are required to maintain similar data for public inspection. 18 C.F.R. § 292.302.

24 The strenuous efforts of utilities to discourage cogeneration, which in part led to the passage of § 210, are described in the legislative history cited in *Federal Energy Regulatory Commission* v. *Mississippi*, *supra*, 102 S. Ct. at 2132, n. 12.

cogenerate, as business conditions may not permit the passage of a year or two before expanding, replacing or reconstructing essential plant and equipment.[25]

Utilities consequently possess tremendous leverage in negotiations. The purchase rate rule took this into account—it gives developers the ultimate right to obtain an avoided costs rate from a state commission *if* they are unable to negotiate a satisfactory contract with the utility. Thus, as FERC expressly recognized, "the ability of a qualifying cogenerator or small power producer to negotiate with an electric utility is buttressed by the existence of the rights and protections of these rules." B-49.

The avoided costs rule is in practice a last resort for the developer, used only when a satisfactory rate simply cannot be negotiated *and* the potential owner of the qualifying facility has the time and money to press the issue before the state public utilities commission. Indeed, what FERC contemplated is precisely what has occurred. Most contracts since promulgation of the rules have been negotiated.[26]

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25 Delays are particularly harmful to those wishing to construct a hydroelectric qualifying facility. Under federal law, preliminary permits issued to preserve one's priority in the licensing process while feasibility studies are made are granted for a limited period of time. 16 U.S.C. § 798 (1976). In many instances, the permit has a life of only 18 months. *See, e.g., Energenics Systems, Inc.*, 19 F.E.R.C. No. 5905-000, 1982 FERC Dec. (CCH) ¶ 62,543 (1982); *Woods Creek, Inc.*, 19 F.E.R.C. No. 5816-000, 1982 FERC Dec. (CCH) ¶ 62,262 (1982). Therefore, a developer who holds out too long in negotiations with a utility stands to lose his all-important status in the licensing process.

26 The Vice-President of Southern California Edison Company, in a recent Senate hearing on the cogeneration and small power production provisions of PURPA, stated that his company has signed 60 contracts with cogenerators and small power producers since the beginning of 1981, "*nearly all* of which have been negotiated at a rate below full avoided cost." *Public Utility Regulatory Policies Act Amendments: Hearings on Amendment No. 1452 to S. 1885 Before the Subcomm. on Energy Regulation of the Senate Comm. on Energy and Natural Resources*, Part 2, 97th Cong., 2d Sess. 110, 114 (1982) (statement of Dr. Glenn J. Bjorklund; emphasis supplied).

The failure of the Court of Appeals panel to appreciate the practical considerations of the entire purchase rate rule, which FERC took into account and which were uniquely within FERC's expertise, undermined the panel's review of the avoided costs rule. As a result, it improperly set the rule aside.

II.

IN VOIDING THE COMMISSION'S INTERCONNECTION RULE, THE COURT FRUSTRATED CLEARLY EXPRESSED CONGRESSIONAL INTENT AND IMPROPERLY LIMITED THE COMMISSION'S AUTHORITY UNDER PURPA

A. The Commission's Interconnection Rule Is In Accord With the Statutes and Congressional Intent to Encourage Alternative Energy Sources

The legislative history of PURPA demonstrates Congress' awareness of a primary obstacle to development of alternative energy sources—the unwillingness of utilities to purchase the power generated by such facilities, or to sell them the backup power they required.[27] *Federal Energy Regulatory Commission* v. *Mississippi, supra,* 102 S. Ct. at 2132. PURPA § 210 was aimed specifically at dismantling this obstacle by requiring utilities to offer to purchase from and sell to qualifying facilities. Congress chose to accomplish its aims through rules prescribed by the Commission. 16 U.S.C. § 824a-3(a).

The Commission's interconnection rule provides that:

> "[A]ny electric utility shall make such interconnections with any qualifying facility as may be necessary to accom-

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27 Particularly in the context of industrial cogeneration, the economics can be overshadowed by the risk of a plant shutdown due to generator failure if the servicing utility refuses to provide back-up power. The rates charged by a utility for such back-up service, or for supplementary power (regularly used in addition to that which is cogenerated), also have a substantial impact on the decision whether to cogenerate, especially if those rates are discriminatory. *See generally* "Con Ed Battles Energy Officials on Cogeneration", New York Times, November 2, 1980, § 8, p. 1.

> plish purchases or sales under this subpart. The obligation to pay for any interconnection costs shall be determined in accordance with § 292.306." 18 C.F.R. § 292.303(c).

The latter section requires that each qualifying facility pay interconnection costs as assessed by the state regulatory authority or nonregulated utility.

The panel set aside this rule as inconsistent with § 210(e)(3)(B) of PURPA, 16 U.S.C. § 824a-3(e)(3)(B), and with the procedural and substantive requirements of §§ 210 and 212 of the Federal Power Act, 16 U.S.C. §§ 824i and k (1976 ed., Supp. III).[28] B-22.

FPA § 210 authorizes FERC, among other things, to issue an order upon application or upon its own motion requiring "the physical connection of any cogeneration facility, any small power production facility, or the transmission facilities of any electric utility, with the facilities of [the] applicant." 16 U.S.C. § 824i(a)(1)(A). An order under this authority may *only* be issued after the Commission issues notice to the affected parties, affords an opportunity for an evidentiary hearing and makes certain specified determinations. 16 U.S.C. § 824i(b) and (c). In addition, FPA § 212 lists certain further steps which must be taken before such an order may issue. 16 U.S.C. § 824k(a), (b) and (c).

Section 210(e) of PURPA requires FERC to exempt qualifying facilities from various federal and state laws which might impede their development. It also provides, however, that:

> "No qualifying small power production facility or qualifying cogeneration facility may be exempted under this subsection from—
>
> * * *
>
> (B) the provisions of section 210, 211 or 212 of the Federal Power Act or the necessary authorities

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28 The latter provisions were added to the FPA by PURPA §§ 202 and 204, respectively.

> for enforcement of any such provision under the Federal Power Act. . . ." 16 U.S.C. § 824a-3(e)(3)(B).

In requiring interconnection, the Commission was cognizant of § 210(e)(3)(B) of PURPA. *See* B-60, 180-81. FERC's interconnection rule, however, does not exempt qualifying facilities from those sections.

The Commission pointed out that PURPA § 210(e) empowered it to exempt qualifying facilities from certain state and federal laws to the extent necessary to encourage the development of such facilities. B-180-81. FERC correctly understood that Congress' intent in granting this exemption authority was to remove the threat of utility-type regulatory burdens on qualifying facilities wherever possible, if necessary to encourage their development. Hence, stated the Commission:

> "[B]y exempting qualifying facilities from this type of regulation, Congress relieved them from liabilities and requirements to which others (*viz.*, non-qualifying facilities) are subject. Use of the word 'exempt' in this context is consistent with its definition: 'to release or deliver from some liability or requirement to which others are subject.' To 'exempt' qualifying facilities does not mean to deny them a privelege [sic] or right to which they would otherwise be entitled; to exempt means to relieve of undesirable responsibility or obligation." B-181 (footnote omitted).

In this light, FERC explained that qualifying facilities can either be applicants for or targets of interconnection orders under § 210 of the Federal Power Act. B-180. That section grants to electric utilities and federal power marketing agencies, as well as to qualifying facilities, the right to apply for an interconnection order. The "target" of such an interconnection order can, under the section, be "any cogeneration facility, any

small power production facility or the transmission facilities of any electric utility."[29] 16 U.S.C. § 824i(a)(1)(A); B-180.

Since, therefore, the Commission may make certain determinations under §§ 210 and 212 of the Federal Power Act which would result in the imposition of significant obligations on a qualifying facility, it is from those obligations that PURPA § 210(e)(3)(B) provides that such facilities may not be exempted. B-181. This reading, the Commission observed, "comports with the plain meaning of the statute and with the accepted use of the language." B-182. It precludes the Commission from relieving qualifying facilities from liability as targets of interconnection orders which are sought by others or, more importantly, which are issued by FERC on its own motion.[30]

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29 It is significant to note that a literal reading of FPA § 210 does not necessarily grant the right to a qualifying facility to obtain interconnection under that section for the purpose of purchases or sales. FPA § 210 (a)(1)(A) empowers the Commission to order:

> "(A) the physical connection of any cogeneration facility, any small power production facility, or the transmission facilities of any electric utility, with the facilities of such applicant."

16 U.S.C. § 824i(a)(1)(A).

Thus, a qualifying facility applying for interconnection with a utility under FPA § 210 would be faced with the argument that the connection can *only* be to the "transmission facilities" of the utility, not to its "distribution facilities."

30 Among other things, a qualifying facility can be ordered to interconnect with the transmission facilities of a utility or with another facility, qualified or not. Similarly, it can be required to take action with respect to its physical connection if the connection is of inadequate size, poorly maintained or physically unreliable. It can also be required to increase its transmission capacity. 16 U.S.C. § 824i(a)(1). These are obligations from which it cannot be exempted.

As FERC argues in its brief, Congress had intentionally created, in §§ 210-212 of the FPA, a much larger jurisdiction for FERC to exercise than it had ever possessed before, for the primary purpose of establishing a truly national transmission grid. The restriction in PURPA § 210(e)(3)(B) on FERC's exemption-granting authority was a necessary precaution to insure that FERC would not undo any part of that novel jurisdictional grant by relieving qualifying facilities of their potential obligations as targets of FERC interconnection orders.

Furthermore, the procedures and proofs involved in an FPA interconnection proceeding are redundant when a qualifying facility wishes to gain a utility interconnection. By requiring "any" utility to make interconnections with "any" cogenerator "FERC designates," the Court of Appeals stated, the Commission would "in effect" exempt qualifying facilities from the other procedural and substantive requirements in FPA §§ 210 and 212 "and deprive utilities of the safeguards afforded by those provisions." B-22. This rationale, however, depends upon a substantial overstatement of the problem faced by the utilities. Apart from the ability to demand a full evidentiary hearing and thereby to delay any interconnection, all the other "safeguards" afforded by FPA §§ 210 and 212 to utilities were adequately protected in FERC's rules.

Under FPA § 210(c), before ordering interconnection, FERC must determine that it is in the public interest and that the order would encourage overall conservation of energy or capital, or optimize the efficient use of facilities and resources, or improve the system reliability, and meet the requirements of FPA § 212. 16 U.S.C. § 824i(c).[31] Under FPA § 212 the Commission may not issue the order unless it determines that it is not likely to result in reasonably ascertainable uncompensated economic loss for the utility affected by the order, will not place an undue burden on that utility, will not unreasonably impair the reliability of the utility, will not impair the ability of the utility to render adequate service to its customers, and that the applicant can reimburse the utility for its expenses in making the interconnection.[32] 16 U.S.C. §§ 824k(a) and (b).

The Commission's rules (and the statute itself) place in the hands of the state regulatory authorities ultimate control over interconnection between utilities and qualifying facilities. This

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31 As these requirements indicate, interconnection orders pursuant to § 210 of the FPA will not automatically be granted.

32 FPA § 212(b)(2) also deals with orders under FPA § 211, which involves wheeling of power between utilities, and the Commission has construed it not to apply to qualifying facilities.

is manifestly consistent with the states' role as monitors of the overall safety and reliability of utility systems. In this respect, FERC broadly provided that the state regulatory authorities themselves establish "reasonable standards to ensure system safety and reliability of interconnected operations" based, *inter alia,* upon recommendations made by the utililties. 18 C.F.R. § 292.308.[33] Moreover, to assure that utilities would not incur unnecessary expenses by interconnection, the rules require the qualifying facility "to pay any interconnection costs which the State regulatory authority . . . or nonregulated electric utility may assess against the qualifying facility on a nondiscriminatory basis . . . . " 18 C.F.R. § 292.306(a).[34]

Under the panel's decision, however, these essentially local responsibilities are shifted back to FERC, which must make case-by-case determinations each time a utility exercises its right to request an evidentiary hearing on an application for interconnection by a qualifying facility.[35] If it is permitted to

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33 Utility concerns regarding the safety and reliability of interconnected operations have been alleviated as states have implemented the FERC rules. State utility commissions have made interconnection safety and reliability a primary element of their rules. In doing so, they have not hesitated to accommodate individual utilities' particular needs. In Colorado, for instance, over half of the Public Utility Commission's 42 pages of cogeneration and small power production rules are devoted to preserving utility system safety, reliability and recoverability of interconnection costs. Attachment 1 to Decision No. R81-801, Colorado P.U.C., May 6, 1981. In many other states, the utility commissions require a qualifying facility to comply with any reasonable utility demand related to interconnection safety and reliability. *See, e.g.,* Arkansas Public Service Commission Order No. 3 in Docket No. 81-071-F, April 29, 1982, § 3.8 (proposed rules); Public Service Commission of Indiana Rule No. 170 IAC 4-4-7(b) (March 20, 1981).

34 At the same time, state regulatory authorities were "to ensure that the interconnection requirements are reasonable, and that associated costs are legitimately incurred." B-91.

35 The panel's interpretation of the statutes also presents formidable practical problems with respect to the implementing role Congress

stand, that ruling will have needlessly erected, in the words of the dissenting judges below, "a formidable, perhaps insurmountable, roadblock to a major energy program." B-208.

FERC's construction of the statutes, however, which resulted in the interconnection rule, would prevent such an untoward result. As observed by the dissenters below, "[the Commission's] alternative interpretation is a plausible one and appears to be more closely in line with Congress' expressed desire to encourage cogeneration."[36] *Id.*

B. The Panel's Rejection of FERC's Interpretation Was Contrary to Principles Established by this Court

FERC's harmonious construction of these statutes was inherently reasonable. The panel's treatment of the Commission's interpretation is contrary to this Court's long-standing teaching that " 'the construction of a statute by those charged with its execution should be followed unless there are compelling indications that it is wrong.' " *N.Y. Dep't of Social*

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envisioned for state regulatory authorities in PURPA § 210(f). 16 U.S.C. § 824a-3(f). This section requires state authorities, not FERC, to enforce the rules prescribed by FERC under § 210(a). *Federal Energy Regulatory Commission* v. *Mississippi, supra,* 102 S. Ct. at 2137. A qualifying facility desiring to purchase and sell energy must, therefore, under the statutory mandate, pursue its rights before the state regulatory authorities. The Court of Appeals would, however, also require it to pursue its interconnection rights before FERC. This requirement would result not only in compounding the time and expense necessary to accomplish purchases and sales, but possibly in the issuance of mutually inconsistent orders.

36 As this Court stated in *Ozawa* v. *United States*, 260 U.S. 178, 194 (1922), the court will give a statute "effect in accordance with its design and purpose, sacrificing, if necessary, the literal meaning in order that the purpose may not fail." Again, the Court noted in *United States* v. *American Trucking Ass'ns*, 310 U.S. 534, 543 (1940), that when statutory language produces results divergent from Congressional purpose, "this Court has followed that purpose, rather than the literal words."

Services v. *Dublino*, 413 U.S. 405, 421 (1973) (citation omitted).[37]

This doctrine carries particular weight where the agency is contemporaneously construing newly enacted legislation:

> "Particularly is this respect due when the administrative practice at stake 'involves a contemporaneous construction of a statute by the men charged with the responsibility of setting its machinery in motion, of making the parts work efficiently and smoothly while they are yet untried and new.' " *Power Reactor Development Co.* v. *International Union of Electrical, Radio and Machine Workers*, 367 U.S. 396, 408 (1961) (citation omitted).

Even if the court below had another reasonable construction, its rejection of the interpretation given by FERC was antithetical to the doctrine enunciated by this Court in *Train* v. *Natural Resources Defense Council*, 421 U.S. 60, 87 (1975):

> "We therefore conclude that the Agency's interpretation of [separate provisions of the statute] was 'correct,' to the extent that it can be said with complete assurance that any particular interpretation of a complex statute such as this is the 'correct' one. Given this conclusion, as well as the facts that the Agency is charged with administration of the Act, and that there has undoubtedly been reliance upon its interpretation by the States and other parties affected by the Act, we have no doubt whatever that its construction was sufficiently reasonable to preclude the Court of Appeals from substituting its judgment for that of the Agency."[38]

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37 *See also Udall* v. *Tallman*, 380 U.S. 1, 16 (1965) ("this Court shows great deference to the interpretation given the statute by the officers or agency charged with its administration").

38 *See also Unemployment Compensation Commission* v. *Aragon*, 329 U.S. 143, 153 (1946) ("To sustain the Commission's application of this statutory term, we need not find that its construction is the only

The decision below, however, has construed PURPA § 210(e) in a manner which unreasonably denies FERC the very power Congress so obviously sought to give it. The Court of Appeals' ruling necessarily imputes to Congress the contradictory intention to encourage cogeneration and small power production with one hand in PURPA § 210(a) and (e)(1), and to stifle it with the other in § 210(e)(3)(B).[39]

The panel opinion thus effectively disregards the long-established rule that "every part of a statute must be construed in connection with the whole, so as to make all the parts harmonize, if possible, and give meaning to each." *Washington Market Co.* v. *Hoffman*, 101 U.S. 112, 116 (1879). The panel insisted that Congress had to grant express authority to order interconnection by rule before it would uphold the Commission. In so doing, it failed to recognize this Court's acknowledgment in *Mourning* v. *Family Publications Service, Inc.*, 411 U.S. 356, 372-73 (1973), that it was not:

> " 'a reasonable canon of interpretation that the draftsmen of acts delegating agency powers, as a practical and realistic matter, can or do include specific consideration

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reasonable one, or even that it is the result we would have reached had the question arisen in the first instance in judicial proceedings").

To date over 34 state utility commissions have completed the process of implementing the FERC rules. This process has been extremely time consuming and in some cases in spite of determined utility opposition. An affirmance of the opinion below will require dismantling these rules. *See Cogeneration and Small Power Production: Hearings on H.R. 6500 Before the Subcomm. on Energy Conservation and Power of the House Comm. on Energy and Commerce*, 97th Cong., 2d Sess. 314 (1982) (statement of Michael J. Zimmer, counsel, Cogeneration Coalition, Inc.)

39 Absent interconnection, purchases of power cannot occur, yet the Court of Appeals panel itself recognized that "one of the most basic purposes of PURPA was to remove the obstacle to cogeneration involved here: utilities were often unwilling to purchase the electric output at all or at an appropriate rate from cogenerators." B-18-19 (footnote omitted).

> of every evil sought to be corrected. . . . [N]o great acquaintance with practical affairs is required to know that such prescience, either in fact or in the minds of Congress, does not exist. Its very absence, moreover, is precisely one of the reasons why regulatory agencies such as the Commission are created, for it is the fond hope of their authors that they bring to their work the expert's familiarity with industry conditions which members of the delegating legislatures cannot be expected to possess.' " [*citing American Trucking Ass'ns* v. *United States*, 344 U.S. 298, 309-10 (1953)].

The "true rule," this Court stated in *Iglehart* v. *Iglehart*, 204 U.S. 478, 484-85 (1907):

> "is to harmonize the whole code, if possible, and to that end the letter of any particular section may sometimes be disregarded in order to accomplish the plain intention of the legislature. Effect must be given to all the language employed, and inconsistent expressions are to be harmonized to reach the real intent of the legislature."

C. The Commission's Interconnection Rule is Essential to Encourage Development of Alternative Energy Facilities

It is self-evident that no purchase or sale transaction can occur unless the qualifying facility is interconnected with the utility's system. Congress' direction to prescribe rules which FERC determines necessary to require utilities to offer to purchase electricity from qualifying facilities is empty verbiage, unless qualifying facilities have, or can promptly secure, a right to interconnection. Successfully carrying out the Congressional mandate depends, both conceptually and pragmatically, on establishing such a right by rule, rather than through individual adversarial proceedings between qualifying facilities and utilities conducted before the Commission. The rule ultimately prescribed by FERC is perfectly suited to Congress' purpose: it requires utilities only to "make such interconnections with any qualifying facility as may be necessary to

accomplish purchases or sales under [these rules]." 18 C.F.R. § 292. 303(c)(1).

During the rulemaking proceedings, a record was developed showing the obvious: financial considerations are crucial in producers' decisions whether to proceed. Under the rules promulgated by FERC, the costs of the physical interconnection must be borne by the qualifying facility. 18 C.F.R. § 292.306. Those costs, as was recognized during the rulemaking proceedings, can be substantial. R 2660.[40]

The expense of interconnection is compounded, however, when, as the court below would have it, a facility already qualifying under the rules' standards or by certification in advance is required to prosecute successfully an interconnection proceeding before FERC under the procedural requirements of FPA §§ 210 and 212.[41] The regulatory procedure required by those sections offers a tremendous potential for abuse through protracted litigation and delay by utilities that wish to inhibit the development of cogeneration and small power production in their service area.[42] The mere possibility

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40 According to Order No. 69, these costs include "costs of connection, switching, metering, transmission, distribution, safety provisions and administrative costs," B-45, and "may include, but are not limited to, operating and maintenance expenses [related to the interconnection], the costs of installation of equipment elsewhere on the utility's system necessitated by the interconnection, and reasonable insurance expenses." B-46.

41 At the present time, the cost to FERC of a contested interconnection proceeding amounts to over $57,000. FERC Notice of Proposed Rulemaking dated September 1, 1982, Docket No. RM 82-38-000, Fees Applicable to Electric Utilities, Cogenerators, and Small Power Producers, at 29-30. Rules presently being considered by the Commission would require an applicant for such an order to pay that sum in advance. *Id.* at 53-54.

42 An interconnection case was before the Commission at the time the review was in progress in the court below. It had been in administrative pretrial hearings for two and a half years at that time. *Central Power & Light Co., et al.*, Docket No. EL79-8. *See* Brief for Respondent Federal Energy Regulatory Commission in *American Electric Power Service Corp., et al.* v. *FERC, et al.*, 675 F.2d 1226 (D.C. Cir. 1982), at 69, n. 80.

that a utility, skilled and resourceful in the ways of regulatory procedure and litigation, may force delays and multiply expenses by contesting an application for interconnection, will magnify the potential developer's perceived risks to the degree that only in the most unusual circumstances would this investment option remain attractive.

Although the panel below suggested that proceedings under FPA §§ 210 and 212 may be "streamlined," it acknowledged that even streamlined procedures may be "too burdensome." B-23. The dissenters from denial of rehearing below noted that it was not apparent how the requirement of an evidentiary hearing could be obviated.[43] B-208, n.3. The inescapable burden placed by the panel's statutory interpretation on would-be developers of qualifying facilities would negate Congress' direction to FERC to encourage alternate energy sources by rule. It would give utilities a powerful tool with which they could hinder, delay and ultimately extract onerous terms from project developers, just as they were able to do before PURPA became law.[44] Of a certainty such a prospect would have a

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43 The panel did not explain under what authority such "streamlining" is permissible in the face of the statutory definition of "evidentiary hearings" and "evidentiary proceeding" as "a proceeding conducted as provided in sections 554, 556 and 557 of Title 5." 16 U.S.C. § 796(20) (1976 ed., Supp. III).

44 One legislator noted in hearings leading to PURPA that:

> "Many electric companies have been willing to interconnect with small producers, but offer unfair rates. For example, one manufacturer of interconnect equipment reports seventy windmills, hydro systems, and photovoltaic arrays use its machinery to connect with electric utilities. The company reports that in two-thirds of these cases, the electric company will accept power from small producers but does not pay for it. Other companies have offered to pay only very low rates—less than the costs of fuel to their least costly generating plants. This is certainly less than the electricity is worth. An ERDA official reports that utilities whose industrial customers produce power generally refuse to purchase surplus power."

Public Utility Rate Proposals of President Carter's Energy Program: Hearings on S. 122, S. 1300, S. 1363, S. 1364 and S. 1469 (Part E) before the Subcomm. on Energy Conservation and Regulation of the Senate Comm. on Energy and Natural Resources, 95th Cong., 1st Sess. 385-86 (1977) (statement of Senator Charles Percy).

substantial chilling effect on the program envisioned by Congress in § 210 of PURPA.

Simply put, the decision of the Court of Appeals will mean that most qualifying facilities will be able to sell to or purchase from a utility only if the utility is willing—precisely the situation which prevailed prior to PURPA. Hence, PURPA § 210's theoretical assurance of a market for sales of power will provide no practical benefit or encouragement.

CONCLUSION

The Commission complied with PURPA when it issued its rule for the purchase of energy from new qualifying cogeneration and small power production facilities based upon a utility's avoided costs. It properly interpreted and applied the statutory mandate in doing so, and was neither arbitrary nor capricious. The Commission's rule requiring utilities to interconnect with qualifying facilities in order to make possible purchases and sales was well within its authority. In setting aside those rules, the Court of Appeals erred in disregarding established limitations on judicial review of agency actions. For these reasons the judgment of the Court of Appeals should be reversed and the rules of the Federal Energy Regulatory Commission should be reinstated.

Respectfully submitted,

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December 6, 1982

Listing of Parent Companies, Subsidiaries and Affiliates of Petitioner

The American Paper Institute, Inc. is a non-profit national trade association of the pulp, paper and paperboard manufacturing industry, whose 163 member companies, and their divisions, subsidiaries and affiliates primarily engaged in the manufacture of pulp, paper and paperboard products are listed below. This list does not include (in the case of diversified member companies) divisions, subsidiaries or affiliates primarily engaged in other businesses.

Alabama River Pulp Company, Inc.
  Subsidiary of Parsons & Whittemore, Inc.
American Can Company
American Convenience Products, Inc.
Amricon Corporation
Appleton Papers, Inc.
  Subsidiary of B.A.T. Industries
Augusta Newsprint Company
Banner Fibreboard Company
Bay West Paper Company
Bear Island Paper Company
Blandin Paper Company
Boise Cascade Corporation
Bowater North America Corporation
Burrows Paper Corporation
J.D. Cahill Company, Inc.
Caraustar Industries, Inc.
  Subsidiaries:
    Ashuelot Paper Company, Inc.
    Austell Box Board Corporation
    Carolina Paper Board Corporation
    Carotell Paper Board Corporation
    Sweetwater Paper Board Company

Chicopee
Division of Johnson & Johnson
Champion International Corporation
The Chesapeake Corporation of Virginia
Cleaners Hanger Company
Clevepak Corporation
The Columbia Corporation
Consolidated Packaging Corporation
Consolidated Papers, Inc.
Container Corporation of America
Subsidiary of Mobil Corporation
The Continental Group, Inc., Continental
Forest Industries
Cottrell Paper Company, Inc.
CPM, Inc.
Crane & Company, Inc.
Subsidiary:
Byron Weston Company
Crown Paper Board Company, Inc.
Crown Zellerbach Corporation
The Crystal Tissue Company
Deerfield Specialty Papers, Inc.
The Dexter Corporation
Diamond International Corporation
Domtar Fine Papers
Dunn Paper Company
Subsidiary of Dennison Mfg. Company
Eastern Fine Paper, Inc.
Division of E.B. Eddy Forest Products, Ltd.
Eastex Division Temple-Eastex, Inc.
Subsidiary of Time, Inc.
Ecusta Paper & Film Group Olin Corporation
Equitable Bag Company, Inc.
Erving Paper Mills
Esleek Manufacturing Company
Exton Paper Manufacturers, Inc.
Federal Paper Board Company, Inc.
Fibre Leather Manufacturing Corporation

Finch, Pruyn & Company, Inc.
Flambeau Paper Corporation
Subsidiary of Pentair, Inc.
Fletcher Paper Company
Fortifiber Corporation
Foster Paper Company
Fox River Paper Company
Fraser Paper, Limited
French Paper Company
FSC Paper Corporation
Subsidiary of Field Enterprises, Inc. and Media General, Inc.
Garden State Paper Company, Inc.
Affiliate of Media General, Inc.
Georgia-Pacific Corporation
Gilman Paper Company
P.H. Glatfelter Company
W.R. Grace & Company
Great Northern Nekoosa Corporation
Green Bay Packaging, Inc.
Greif Board Corporation
Gulf States Paper Corporation
Halltown Paperboard Company
Hammermill Paper Company
Hampden Papers, Inc.
Harriman Paperboard Company
Hazen Paper Company
Heller and Usdan, Inc.
Hercules Inc.
Hoffmaster Company, Inc.
Hollingsworth & Vose Company
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Holyoke Card & Paper Company
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ITT Rayonier, Inc.
James River Corporation of Virginia
Jen-Coat, Inc.
Keyes Fibre Company
Kieffer Paper Mills, Inc.
Lawrence Paperboard Corporation
Linweave, Inc.
Litton Industries, Inc.
Longview Fibre Company
Louisiana-Pacific Corporation
Lowe Paper Company
Ludlow Corporation
Lydall Inc.
MacMillan Bloedel, Inc.
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McIntyre Bros. Paper Company, Inc.
Manistique Pulp & Paper Company
  Subsidiary of Field Enterprises, Inc.
Manville Forest Products Corporation
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Marcal Paper Mills, Inc.
The Mead Corporation
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Menominee Paper Co., Inc.
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Merrimac Paper Company, Inc.
Midtec Paper Corporation
Millers Falls Paper Company
Missisquoi
Mohawk Paper Mills, Inc.
Monadnock Paper Mills, Inc.
Morris Paper Board Company
  Division of Berlis Carton Company, Inc.
Mosinee Paper Corporation
National Gypsum Company
The Newark Group
  Subsidiaries:
    California Paperboard Corporation

Connecticut Paperboard Corporation
Haverhill Paperboard Corporation
Middletown Paperboard Corporation
Natick Paperboard Corporation
Newark Boxboard Company
Wisconsin Paperboard Corporation
Newman & Company, Inc.
Newton Falls Paper Mill, Inc.
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Subsidiary of Philip Morris, Inc.
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Orchids Paper Products-Concel, Inc.
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Division of Tenneco, Inc.
Paper Art Company, Inc.
Paper Products, Inc.
Parsons Paper Division, The NVF Company
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Port Huron Paper Company
Potlatch Corporation
Potsdam Paper Company
The Procter & Gamble Company
Subsidiary:
The Buckeye Cellulose Corporation
The Quaker Oats Company
Riegel Textile Corporation
Rising Paper Company
Rock-Tenn Company
St. Joe Paper Company
St. Regis Paper Company

Scott Paper Company
  Affiliate:
    Brunswick Pulp & Paper Company
Seaman Paper Company of Massachusetts, Inc.
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Simpson Paper Co.
  Subsidiary of Simpson Timber Company
H.P. Smith Paper Company
Sonoco Products Company
The Sorg Paper Company
Southeast Paper Manufacturing Company
Southwest Forest Industries, Inc.
Southworth Company
Springprint Paper Products Co.
Stevens & Thompson Paper Company
  Division of Dixico Inc.
Stirling Converting Company, Inc.
Stone Container Corporation
Sullivan Paper Company
Tagsons Papers, Inc.
The Tuttle Press Company
  Division of Fox Valley Corporation
Union Camp Corporation
Virginia Fibre Corporation
West Carrollton Parchment Company
Weston Paper and Manufacturing Company, Inc.
Westvaco Corporation
Weyerhaeuser Company
Whitestone Products
  Division of IPCO Hospital Supply Corporation
Willamette Industries, Inc.
Wisconsin Tissue Mills, Inc.
  Affiliate of Philip Morris, Inc.
Yorktowne Paper Mills, Inc.
  Subsidiary: Yorktowne Paper Mills of Maine

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Statutory Provisions

Section 210 of PURPA provides (16 U.S.C. § 824a-3):

(a) COGENERATION AND SMALL POWER PRODUCTION RULES Not later than 1 year after the date of enactment of this Act, the Commission shall prescribe, and from time to time thereafter revise, such rules as it determines necessary to encourage cogeneration and small power production which rules require electric utilities to offer to—

(1) sell electric energy to qualifying cogeneration facilities and qualifying small power production facilities and

(2) purchase electric energy from such facilities.

Such rules shall be prescribed, after consultation with representatives of Federal and State regulatory agencies having ratemaking authority for electric utilities, and after public notice and a reasonable opportunity for interested persons (including State and Federal agencies) to submit oral as well as written data, views, and arguments. Such rules shall include provisions respecting minimum reliability of qualifying cogeneration facilities and qualifying small power production facilities (including reliability of such facilities during emergencies) and rules respecting reliability of electric energy service to be available to such facilities from electric utilities during emergencies. Such rules may not authorize a qualifying cogeneration facility or qualifying small power production facility to make any sale for purposes other than resale.

(b) RATES FOR PURCHASES BY ELECTRIC UTILITIES The rules prescribed under subsection (a) shall insure that, in

requiring any electric utility to offer to purchase electric energy from any qualifying cogeneration facility or qualifying small power production facility, the rates for such purchase—

(1) shall be just and reasonable to the electric consumers of the electric utility and in the public interest, and

(2) shall not discriminate against qualifying cogenerators or qualifying small power producers.

No such rule prescribed under subsection (a) shall provide for a rate which exceeds the incremental cost to the electric utility of alternative electric energy.

(c) RATES FOR SALES BY UTILITIES The rules prescribed under subsection (a) shall insure that, in requiring any electric utility to offer to sell electric energy to any qualifying cogeneration facility or qualifying small power production facility, the rates for such sale—

(1) shall be just and reasonable and in the public interest, and

(2) shall not discriminate against the qualifying cogenerators or qualifying small power producers.

(d) DEFINITION For purposes of this section, the term "incremental cost of alternative electric energy" means, with respect to electric energy purchased from a qualifying cogenerator or qualifying small power producer, the cost to the electric utility of the electric energy which, but for the purchase from such cogenerator or small power producer, such utility would generate or purchase from another source.

(e) EXEMPTIONS (1) Not later than 1 year after the date of enactment of this Act and from time to time thereafter, the Commission shall, after consultation with representatives of State regulatory authorities, electric utilities, owners of cogeneration facilities and owners of small power production facilities, and after public notice and a reasonable opportunity for interested persons (including State and Federal agencies) to submit oral as well as written data, views, and arguments,

prescribe rules under which qualifying cogeneration facilities and qualifying small power production facilities are exempted in whole or part from the Federal Power Act, from the Public Utility Holding Company Act, from State laws and regulations respecting the rates, or respecting the financial or organizational regulation, of electric utilities, or from any combination of the foregoing, if the Commission determines such exemption is necessary to encourage cogeneration and small power production.

(2) No qualifying small power production facility which has a power production capacity which, together with any other facilities located at the same site (as determined by the Commission), exceeds 30 megawatts may be exempted under rules under paragraph (1) from any provision of law or regulation referred to in paragraph (1), except that any qualifying small power production facility which produces electric energy solely by the use of biomass as a primary energy source, may be exempted by the Commission under such rules from the Public Utility Holding Company Act and from State laws and regulations referred to in such paragraph (1).

(3) No qualifying small power production facility or qualifying cogeneration facility may be exempted under this subsection from—

(A) any State law or regulation in effect in a State pursuant to subsection (f),

(B) the provisions of section 210, 211, or 212 of the Federal Power Act or the necessary authorities for enforcement of any such provision under the Federal Power Act, or

(C) any license or permit requirement under part I of the Federal Power Act, any provision under such Act related to such a license or permit requirement, or the necessary authorities for enforcement of any such requirement.

(f) IMPLEMENTATION OF RULES FOR QUALIFYING COGENERATION AND QUALIFYING SMALL POWER PRODUCTION

FACILITIES (1) Beginning on or before the date one year after any rule is prescribed by the Commission under subsection (a) or revised under such subsection, each State regulatory authority shall, after notice and opportunity for public hearing, implement such rule (or revised rule) for each electric utility for which it has ratemaking authority.

(2) Beginning on or before the date one year after any rule is prescribed by the Commission under subsection (a) or revised under such subsection, each nonregulated electric utility shall, after notice and opportunity for public hearing, implement such rule (or revised rule).

(g) JUDICIAL REVIEW AND ENFORCEMENT (1) Judicial review may be obtained respecting any proceeding conducted by a State regulatory authority or nonregulated electric utility for purposes of implementing any requirement of a rule under subsection (a) in the same manner, and under the same requirements, as judicial review may be obtained under section 123 in the case of a proceeding to which section 123 applies.

(2) Any person (including the Secretary) may bring an action against any electric utility, qualifying small power producer, or qualifying cogenerator to enforce any requirement established by a State regulatory authority or nonregulated electric utility pursuant to subsection (f). Any such action shall be brought only in the manner, and under the requirements, as provided under section 123 with respect to an action to which section 123 applies.

(h) COMMISSION ENFORCEMENT (1) For purposes of enforcement of any rule prescribed by the Commission under subsection (a) with respect to any operations of an electric utility, a qualifying cogeneration facility or a qualifying small power production facility which are subject to the jurisdiction of the Commission under part II of the Federal Power Act, such rule shall be treated as a rule under the Federal Power Act. Nothing in subsection (g) shall apply to so much of the operations of an electric utility, a qualifying cogeneration facility or a qualifying small power production facility as are

subject to the jurisdiction of the Commission under part II of the Federal Power Act.

(2)(A) The Commission may enforce the requirements of subsection (f) against any State regulatory authority or nonregulated electric utility. For purposes of any such enforcement, the requirements of subsection (f)(1) shall be treated as a rule enforceable under the Federal Power Act. For purposes of any such action, a State regulatory authority or nonregulated electric utility shall be treated as a person within the meaning of the Federal Power Act. No enforcement action may be brought by the Commission under this section other than—

(i) an action against the State regulatory authority or nonregulated electric utility for failure to comply with the requirements of subsection (f) or

(ii) an action under paragraph (1).

(B) Any electric utility, qualifying cogenerator, or qualifying small power producer may petition the Commission to enforce the requirements of subsection (f) as provided in subparagraph (A) of this paragraph. If the Commission does not initiate an enforcement action under subparagraph (A) against a State regulatory authority or nonregulated electric utility within 60 days following the date on which a petition is filed under this subparagraph with respect to such authority, the petitioner may bring an action in the appropriate United States district court to require such State regulatory authority or nonregulated electric utility to comply with such requirements, and such court may issue such injunctive or other relief as may be appropriate. The Commission may intervene as a matter of right in any such action.

(i) FEDERAL CONTRACTS No contract between a Federal agency and any electric utility for the sale of electric energy by such Federal agency for resale which is entered into after the date of the enactment of this Act may contain any provision which will have the effect of preventing the implementation of any rule under this section with respect to such utility. Any

provision in any such contract which has such effect shall be null and void.

(j) DEFINITIONS For purposes of this section, the terms "small power production facility," "qualifying small power production facility," "qualifying small power producer," "primary energy source," "cogeneration facility," "qualifying cogeneration facility," and "qualifying cogenerator" have the respective meanings provided for such terms under section 3 (17) and (18) of the Federal Power Act.

Section 210 of the Federal Power Act provides (16 U.S.C. § 824i):

(a) POWERS OF COMMISSION; APPLICATION BY STATE REGULATORY AUTHORITY (1) Upon application of any electric utility, Federal power marketing agency, qualifying cogenerator, or qualifying small power producer, the Commission may issue an order requiring—

(A) the physical connection of any cogeneration facility, any small power production facility, or the transmission facilities of any electric utility, with the facilities of such applicant,

(B) such action as may be necessary to make effective any physical connection described in subparagraph (A), which physical connection is ineffective for any reason, such as inadequate size, poor maintenance, or physical unreliability,

(C) such sale or exchange of electric energy or other coordination, as may be necessary to carry out the purposes of any order under subparagraph (A) or (B), or

(D) such increase in transmission capacity as may be necessary to carry out the purposes of any order under subparagraph (A) or (B).

(2) Any State regulatory authority may apply to the Commission for an order for any action referred to in subparagraph (A), (B), (C), or (D) of paragraph (1). No such order may be issued by the Commission with respect to a Federal power marketing agency upon application of a State regulatory authority.

(b) NOTICE, HEARING AND DETERMINATION BY COMMISSION Upon receipt of an application under subsection (a) of this section, the Commission shall—

(1) issue notice to each affected State regulatory authority, each affected electric utility, each affected Federal power marketing agency, each affected owner or operator of a cogeneration facility or of a small power production facility, and to the public.

(2) afford an opportunity for an evidentiary hearing, and

(3) make a determination with respect to the matters referred to in subsection (c) of this section.

(c) NECESSARY FINDINGS No order may be issued by the Commission under subsection (a) of this section unless the Commission determines that such an order—

(1) is in the public interest,

(2) would—

(A) encourage overall conservation of energy or capital,

(B) optimize the efficiency of use of facilities and resources, or

(C) improve the reliability of any electric utility system or Federal power marketing agency to which the order applies, and

(3) meets the requirements of section 824k [FPA § 212] of this title.

(d) MOTION OF COMMISSION The Commission may, on its own motion, after compliance with the requirements of paragraphs (1) and (2) of subsection (b) of this section, issue an order requiring any action described in subsection (a)(1) of this section if the Commission determines that such order meets the requirements of subsection (c) of this section. No such order may be issued upon the Commission's own motion with respect to a Federal power marketing agency.

(e) DEFINITIONS (1) As used in this section, the term "facilities" means only facilities used for the generation or transmission of electric energy.

(2) With respect to an order issued pursuant to an application of a qualifying cogenerator or qualifying small power producer under subsection (a)(1) of this section, the term "facilities of such applicant" means the qualifying cogeneration facilities or qualifying small power production facilities of the applicant, as specified in the application. With respect to an order issued pursuant to an application under subsection (a)(2) of this section, the term "facilities of such applicant" means the qualifying cogeneration facilities, qualifying small power production facilities, or the transmission facilities of an electric utility, as specified in the application. With respect to an order issued by the Commission on its own motion under subsection (d) of this section, such term means the qualifying cogeneration facilities, qualifying small power production facilities, or the transmission facilities of an electric utility, as specified in the proposed order.

Section 212 of the Federal Power Act provides (16 U.S.C. § 824k):

(a) DETERMINATIONS BY COMMISSION No order may be issued by the Commission under section 824i [FPA § 210] or subsection (a) or (b) of section 824j [FPA § 211] of this title unless the Commission determines that such order—

(1) is not likely to result in a reasonably ascertainable uncompensated economic loss for any electric utility, qualifying cogenerator, or qualifying small power producer, as the case may be, affected by the order;

(2) will not place an undue burden on an electric utility, qualifying cogenerator, or qualifying small power producer, as the case may be, affected by the order;

(3) will not unreasonably impair the reliability of any electric utility affected by the order; and

(4) will not impair the ability of any electric utility affected by the order to render adequate service to its customers.

The determination under paragraph (1) shall be based upon a showing of the parties. The Commission shall have no authority under section 824i or 824j of this title to compel the enlargement of generating facilities.

(b) REIMBURSEMENT OF PARTIES SUBJECT TO ORDERS No order may be issued under section 824i or subsection (a) or (b) of section 824j of this title unless the applicant for such order demonstrates that he is ready, willing, and able to reimburse the party subject to such an order for—

(1) in the case of an order under section 824i of this title, such party's share of the reasonably anticipated costs incurred under such order, and

(2) in the case of an order under subsection (a) or (b) of section 824j of this title—

(A) the reasonable costs of transmission services, including the costs of any enlargement of transmission facilities, and

(B) a reasonable rate of return on such costs, as appropriate, as determined by the Commission.

(c) ISSUANCE OF PROPOSED ORDER; AGREEMENT BY PARTIES TO TERMS AND CONDITIONS OF ORDER; APPROVAL BY COMMISSION; INCLUSION IN FINAL ORDER; FAILURE TO AGREE (1) Before issuing an order under section 824i or subsection (a) or (b) of section 824j of this title, the Commission shall issue a proposed order and set a reasonable time for parties to the proposed interconnection or transmission order to agree to terms and conditions under which such order is to be carried out, including the apportionment of costs between them and the compensation or reimbursement reasonably due to any of them. Such proposed order shall not be reviewable or enforceable in any court. The time set for such parties to agree to such terms and conditions may be shortened if the Commission determines that delay would jeopardize the attainment of the purposes of any proposed order. Any terms and conditions agreed to by the parties shall be subject to the approval of the Commission.

(2)(A) If the parties agree as provided in paragraph (1) within the time set by the Commission and the Commission approves such agreement, the terms and conditions shall be included in the final order. In the case of an order under section 824i of this title, if the parties fail to agree within the time set by the Commission or if the Commission does not approve any such agreement, the Commission shall prescribe such terms and conditions and include such terms and conditions in the final order.

(B) In the case of any order applied for under section 824j of this title, if the parties fail to agree within the time set by the Commission, the Commission shall prescribe such terms and conditions in the final order.

Statement of reasons for denial

(d) If the Commission does not issue any order applied for under section 824i or 824j of this title, the Commission shall, by order, deny such application and state the reasons for such denial.

(e) UTILIZATION OF INTERCONNECTION OR WHEELING AUTHORITY IN LIEU OF OTHER AUTHORITY; LIMITATION OF COMMISSION AUTHORITY No provision of section 824i or 824j of this title shall be treated—

(1) as requiring any person to utilize the authority of such section 824i or 824j of this title in lieu of any other authority of law, or

(2) as limiting, impairing, or otherwise affecting any authority of the Commission under any other provision of law.

(f) EFFECTIVE DATE OF ORDER; HEARING; NOTICE; REVIEW (1) No order under section 824i or 824j of this title requiring the Tennessee Valley Authority (hereinafter in this subsection referred to as the "TVA") to take any action shall take effect for 60 days following the date of issuance of the order. Within 60 days following the issuance by the Commission of any order under section 824i or of section 824j of this title requiring the TVA to enter into any contract for the sale or delivery of power, the Commission may on its own motion initiate, or upon petition of any aggrieved person shall initiate, an evidentiary hearing to determine whether or not such sale or delivery would result in violation of the third sentence of section 15d(a) of the Tennessee Valley Authority Act of 1933, hereinafter in this subsection referred to as the TVA Act.

(2) Upon initiation of any evidentiary hearing under paragraph (1), the Commission shall give notice thereof to any applicant who applied for and obtained the order from the Commission, to any electric utility or other entity subject to

such order, and to the public, and shall promptly make the determination referred to in paragraph (1). Upon initiation of such hearing, the Commission shall stay the effectiveness of the order under section 824i or 824j of this title until whichever of the following dates is applicable—

(A) the date on which there is a final determination (including any judicial review thereof under paragraph (3)) that no such violation would result from such order, or

(B) the date on which a specific authorization of the Congress (within the meaning of the third sentence of section 15d(a) of the TVA Act) takes effect.

(3) Any determination under paragraph (1) shall be reviewable only in the appropriate court of the United States upon petition filed by any aggrieved person or municipality within 60 days after such determination, and such court shall have jurisdiction to grant appropriate relief. Any applicant who applied for and obtained the order under section 824i or 824j of this title, and any electric utility or other entity subject to such order shall have the right to intervene in any such proceeding in such court. Except for review by such court (and any appeal or other review by an appellate court of the United States), no court shall have jurisdiction to consider any action brought by any person to enjoin the carrying out of any order of the Commission under section 824i or section 824j of this title requiring the TVA to take any action on the grounds that such action requires a specific authorization of the Congress pursuant to the third sentence of section 15d(a) of the TVA Act.

Regulatory Provisions

The Federal Energy Regulatory Commission's definition of "Avoided costs" provides (18 C.F.R. § 292.101(b)(6)):

(6) "Avoided costs" means the incremental costs to an electric utility of electric energy or capacity or both which, but for the purchase from the qualifying facility or qualifying facilities, such utility would generate itself or purchase from another source.

The Federal Energy Regulatory Commission's "interconnection" rule provides (18 C.F.R. § 292.303(c)(1)):

(c) *Obligation to interconnect.* (1) Subject to paragraph (c)(2) of this section, any electric utility shall make such interconnections with any qualifying facility as may be necessary to accomplish purchases or sales under this subpart. The obligation to pay for any interconnection costs shall be determined in accordance with § 292.306.

The Federal Energy Regulatory Commission's "Rates for purchases" rule provides (18 C.F.R. § 292.304):

(a) *Rates for purchases.* (1) Rates for purchases shall:

(i) be just and reasonable to the electric consumer of the electric utility and in the public interest; and

(ii) not discriminate against qualifying cogeneration and small power production facilities.

(2) Nothing in this subpart requires any electric utility to pay more than the avoided costs for purchases.

(b) *Relationship to avoided costs.* (1) For purposes of this paragraph, "new capacity" means any purchase from capacity of a qualifying facility, construction of which was commenced on or after November 9, 1978.

(2) Subject to subparagraph (3), a rate for purchases satisfies the requirements of paragraph (a) if the rate equals the

avoided costs determined after consideration of the factors set forth in paragraph (e).

(3) A rate for purchases (other than from new capacity) may be less than the avoided cost if the State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or the nonregulated electric utility determines that a lower rate is consistent with paragraph (a), and is sufficient to encourage cogeneration and small power production.

(4) Rates for purchases from new capacity shall be in accordance with subparagraph (2), regardless of whether the electric utility making such purchases is simultaneously making sales to the qualifying facility.

(5) In the case in which the rates for purchases are based upon estimates of avoided costs over the specific term of the contract or other legally enforceable obligation, the rates for such purchases do not violate this subpart if the rates for such purchases differ from avoided costs at the time of delivery.

(c) *Standard rates for purchases.* (1) There shall be put into effect (with respect to each electric utility) standard rates for purchases from qualifying facilities with a design capacity of 100 kilowatts or less.

(2) There may be put into effect standard rates for purchases from qualifying facilities with a design capacity of more than 100 kilowatts.

(3) The standard rates for purchases under this paragraph:

(i) shall be consistent with paragraphs (a) and (e); and

(ii) may differentiate among qualifying facilities using various technologies on the basis of the supply characteristics of the different technologies.

(d) *Purchases "as available" or pursuant to a legally enforceable obligation.* Each qualifying facility shall have the option either:

(1) to provide energy as the qualifying facility determines such energy to be available for such purchases, in which case the rates for such purchases shall be based on the purchasing utility's avoided costs calculated at the time of delivery; or

(2) to provide energy or capacity pursuant to a legally enforceable obligation for the delivery of energy or capacity over a specified term, in which case the rates for such purchases shall, at the option of the qualifying facility exercised prior to the beginning of the specified term, be based on either:

(i) the avoided costs calculated at the time of delivery; or

(ii) the avoided costs calculated at the time the obligation is incurred.

(e) *Factors affecting rates for purchases.* In determining avoided costs, the following factors shall, to the extent practicable, be taken into account:

(1) the data provided pursuant to § 292.302(b), (c), or (d), including State review of any such data;

(2) the availability of capacity or energy from a qualifying facility during the system daily and seasonal peak periods, including:

(i) the ability of the utility to dispatch the qualifying facility;

(ii) the expected or demonstrated reliability of the qualifying facility;

(iii) the terms of any contract or other legally enforceable obligation, including the duration of the obligation, termination notice requirement and sanctions for non-compliance;

(iv) the extent to which scheduled outages of the qualifying facility can be usefully coordinated with scheduled outages of the utility's facilities;

(v) the usefulness of energy and capacity supplied from a qualifying facility during system emergencies, including its ability to separate its load from its generation;

(vi) the individual and aggregate value of energy and capacity from qualifying facilities on the electric utility's system; and

(vii) the smaller capacity increments and the shorter lead times available with additions of capacity from qualifying facilities; and

(3) the relationship of the availability of energy or capacity from the qualifying facility as derived in subparagraph (2), to the ability of the electric utility to avoid costs, including the deferral of capacity additions and the reduction of fossil fuel use; and

(4) the costs or savings resulting from variations in line losses from those that would have existed in the absence of purchases from a qualifying facility, if the purchasing electric utility generated an equivalent amount of energy itself or purchased an equivalent amount of electric energy or capacity.

(f) *Periods during which purchases not required.*

(1) Any electric utility which gives notice pursuant to subparagraph (2) will not be required to purchase electric energy or capacity during any period during which, due to operational circumstances, purchases from qualifying facilities will result in costs greater than those which the utility would incur if it did not make such purchases, but instead generated an equivalent amount of energy itself.

(2) Any electric utility seeking to invoke subparagraph (1) must notify, in accordance with applicable State law or regulation, each affected qualifying facility in time for the qualifying facility to cease the delivery of energy or capacity to the electric utility.

(3) Any electric utility which fails to comply with the provisions of subparagraph (2) will be required to pay the same rate for such purchase of energy or capacity as would be required had the period described in subparagraph (1) not occurred.

(4) A claim by an electric utility that such a period has occurred or will occur is subject to such verification by its State regulatory authority as the State regulatory authority determines necessary or appropriate, either before or after the occurrence.

The Federal Energy Regulatory Commission's "Waivers" rule provides (18 C.F.R. § 292.403(a)):

(a) *State regulatory authority and nonregulated electric utility waivers.* Any State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or nonregulated electric utility may, after public notice in the area served by the electric utility, apply for a waiver from the application of any of the requirements of Subpart C [§§ 292.301-.308] (other than § 292.302 thereof).